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STAFF QUESTIONS AND ANSWERS

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ACCOUNTING FOR SOVEREIGN DEBT RESTRUCTURINGS UNDER IPSAS

This Questions and Answers (Q&A) publication is issued by the staff of the International Public Sector Accounting Standards Board® (IPSASB) to highlight how International Public Sector Accounting Standards™ (IPSASs™) reflect the accounting consequences of sovereign debt restructuring transactions.

> *"The objective of this document is to indicate how IPSASs deal with transactions and events which arise through sovereign debt restructurings."*

This publication does not constitute an authoritative pronouncement of the IPSASB, nor does it intend to amend or override the requirements of existing IPSASs or provide further implementation guidance. This publication is not meant to be exhaustive and is not a substitute for reading the related IPSASs on financial instruments.

Background

There has been considerable recent discussion about sovereign debt issues, including restructurings. The objective of this document is to indicate how IPSASs deal with transactions which may arise through sovereign debt restructurings.

Recent discussions on sovereign debt restructurings emphasize the need for improved public sector financial reporting, through the adoption and implementation of transparent, high-quality, conceptual-based accrual accounting standards, designed for the public sector, such as IPSASs.

This Q&A highlights issues which may be encountered in a sovereign debt restructuring. It illustrates how IPSASs, at a high level of principle, capture the economic consequences of debt restructurings. It does not reference any specific transaction, nor is it intended to be used as application or implementation guidance during sovereign debt restructurings. The terms and conditions of specific restructurings are highly complex and voluminous. These terms and conditions may include, but are not limited to, the extension of maturities, reductions in interest rates, changes in counterparties and the issuance of additional complex financial instruments.

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Q1. *Under IPSASs, which standards deal with accounting for financial instruments?*

The suite of IPSASs includes comprehensive financial instruments standards: IPSAS 28, *Financial Instruments: Presentation,* IPSAS 29, *Financial Instruments: Recognition and Measurement,* and IPSAS 30, *Financial Instruments: Disclosures*.

Q2. *Are the requirements of IPSASs for financial liabilities consistent with International Financial Reporting Standards?*

Yes, IPSASs 28–30 were developed with reference to the IFRS financial instruments standards[1] with modifications for public sector specific issues[2]. Public sector guidance was included for concessionary loans[3] and large scale financial guarantees[4].

The IPSASB approved IPSASs 28–30 in 2009. IPSASs 28–30 were consistent with IFRS requirements at December 31, 2008. In July 2014, the International Accounting Standards Board completed its project to develop new financial instruments requirements and approved IFRS 9, *Financial Instruments.* The IPSASB has a project in its work plan to update IPSASs 28–30, which will consider the requirements of IFRS 9.

Q3. *What are the recognition and measurement requirements for financial liabilities in IPSASs?*

IPSAS 29 provides the requirements for recognition and measurement of financial instruments. The recognition and measurement requirements for financial liabilities are most relevant for sovereign debt restructurings.

The standard requires that financial liabilities, which include loans and debt securities, are measured initially at fair value with subsequent measurement at amortized cost using the effective interest method[5]. IPSAS 29 provides limited exceptions to subsequent measurement at amortized cost, but these exceptions would rarely be applicable for loans and debt securities.

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1 IPSASs 28–30 were developed with reference to the IFRS financial instruments standards in place in 2008 when the project to develop the IPSAS standards was completed.

2 The IPSASB has a policy paper, *Process for Reviewing and Modifying IASB Documents,* which was published in October 2008. The IPSASB followed the guidance in the policy paper when considering departures from the IASB requirements for public sector issues.

3 IPSAS 29 AG84–AG90 contain detailed requirements for accounting for concessionary loans.

4 IPSAS 29 AG92–AG97 contain detailed requirements for accounting for financial guarantees issued through a non-exchange transaction, including the valuation of such guarantees

5 IPSAS 29.45 contains requirements for the initial measurement of financial assets and financial liabilities and IPSAS 29.49 contains requirements for the subsequent measurement of financial liabilities.

Q4. ***What are the requirements for loans provided at non-market terms in IPSASs?***

IPSAS 29 contains public sector specific application guidance on concessionary loans, which are loans granted at non-market terms[6]. These requirements are not drawn from IFRS.

Sovereign debt restructurings should be assessed to determine if a concessionary loan has been received or granted. A loan is deemed to be concessionary when the transaction price based on the contractual terms is not equivalent to the fair value of the loan. Concessionary loans are recognized at fair value, with the difference between the transaction price and fair value treated in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. The loan is subsequently measured at amortized cost using the effective interest method.

The application guidance distinguishes concessionary loans from waivers of debt[7]. This is important because it impacts whether the non-market terms of the agreement are considered as part of the initial measurement of the concessionary loan, rather than as part of the subsequent measurement or derecognition of the existing loan. Concessionary loans from the outset are intended to provide resources at non-market rates. Waivers of debt result from modifications to existing loan agreements, initially granted at market terms and the derecognition requirements of IPSAS 29 apply.

Q5. ***What are the derecognition requirements for financial liabilities in IPSASs?***

Financial liabilities are derecognized[8] when they are extinguished under the following circumstances:

- The obligation is settled through payment;
- The obligation is assumed by a third party; or
- The terms and conditions of the arrangement are substantially modified.

A substantial modification in terms occurs when the discounted present value of the cash flows including fees, is at least 10 percent different from the discounted present value of the remaining cash flows of the original financial liability[9].

The magnitude of the change depends on the specific terms of the restructuring. If the modification is substantially different, the original debt is derecognized as it is deemed to be extinguished, and any costs or fees incurred are recognized as part of the gain or loss on that extinguishment. Following derecognition of the original liability, the substantially modified liability is then subject to initial recognition requirements under IPSAS 29.

If a modification is not considered substantial, there is not an extinguishment and the original financial liability is not derecognized. There will, however, be a change in the carrying amount of the financial liability, based the modified future cash flows. Any costs or fees incurred adjust the carrying amount and are amortized over the remaining term of the modified financial liability.

[6] IPSAS 29 AG84–AG90 contain detailed requirements for accounting for concessionary loans.

[7] IPSAS 29 AG85–AG86 contain guidance on distinguishing between a concessionary loan or a waiver of debt and the different accounting treatments for each.

[8] IPSAS 29.41–44 contain requirements for accounting for derecognition of financial liabilities.

[9] IPSAS 29 AG79 contains requirements for assessing the extent of modifications.

Q6. ***Do financial instrument requirements in IPSASs define "debt" or "net debt"?***

No, IPSASs do not specifically define debt or net debt.

IPSASs require entities to present a comprehensive statement of financial position, including all assets and liabilities of an entity (financial and non-financial). IPSASs do not emphasize individual line items, such as financial liabilities, or components of individual line items, such as debt in isolation from other liabilities. This is because IPSASs emphasize fair presentation, which is the complete view of the financial position of an entity, including its resources and the claims on those resources. IPSASs have been developed so that a full set of general purpose financial statements present a fair view of an entity's finances. Although debt is not a defined term in IPSASs, the measurement of financial liabilities and their presentation in IPSAS-compliant general purpose financial statements provide the information users need for accountability and decision-making purposes.

The IPSASB considered the broader need for general purpose financial reports and included guidance on presentation of non-IPSAS measures in Recommended Practice Guideline (RPG) 2, *Financial Discussion and Analysis.* RPG 2 notes that where non-IPSAS measures are presented, this fact should be disclosed, and they should be explained, and reconciled to the related IPSAS measures presented in the financial statements[10].

Q7. ***Are IPSASs requirements consistent with government finance statistics reporting guidelines for loans and debt securities (e.g., SNA, GFS or ESA)?***

No, IPSASs and government finance statistics (GFS) reporting guidelines have different objectives. The objectives of financial reporting by public sector entities are to provide information about the reporting entity that is useful to users of general purpose financial reports for accountability and decision-making purposes. GFS reports are used to (a) analyze fiscal policy options, make policy and evaluate the impact of fiscal policies, (b) determine the impact on the economy and (c) compare fiscal outcomes nationally or internationally. The focus is on evaluating the impact of the general government sector and broader public sector on the economy, within the complete macroeconomic statistics framework.

The common GFS reporting frameworks are:

- System of National Accounts (SNA) 2008;
- Government Finance Statistics Manual (GFSM) 2014;
- Balance of Payments and International Investments Position Manual-Sixth Edition (BPM6); and
- European System of National Accounts (ESA) 2010.

A key difference between the IPSAS and GFS reporting frameworks relates to measurement. Under GFS, debt securities are measured at market value[11]. Loans are measured at nominal[12] value for both debtors and creditors[13]. Concessionary loans[14] are measured at nominal value, with the difference between the contract value and the present value of the loans, presented as a

[10] RPG 2.24 provides requirements for using non-IPSAS measures in general purpose financial reports.

memorandum item (note disclosure). SNA has concessionary loans on the current research agenda.

Q8. ***Are the requirements of IPSASs consistent with Maastricht Treaty requirements?***

No, the measurement requirements in IPSAS 29 are not consistent with the Excessive Deficit Procedure (EDP), which stemmed from the Maastricht Treaty in 1992.

Discussions of sovereign debt restructurings in Europe often cite debt measures based on the EDP. The EDP is the legal requirement to assess fiscal compliance of government debts and deficits for European Union member countries. The EDP uses data and terminology from ESA 2010. However, for EDP purposes, government debt securities are measured at face value, unlike ESA 2010 which measures such instruments at market value. Under the EDP government debt includes:

- Currency and deposits;
- Securities other than shares (excluding derivatives); and
- Loans.

[11] Paragraph 7.67 of ESA 2010. Paragraph 13.58 of SNA 2008. Paragraph 7.154 of GFSM 2014.

[12] Paragraph 3.157 b–d notes nominal value refers to the amount the debtor owes to the creditor, which comprises the outstanding principal amount including any accrued interest. Amortized value reflects the amount at which the financial asset or liability was measured at initial recognition minus the principal repayments. Excess payments over the scheduled repayments reduce the amortized value whereas payments that are less than the scheduled principal repayments or scheduled interest increase the amortized value. On each scheduled date, amortized value is the same as nominal value, but it may differ from the nominal value on other dates due to the accrued interest being included in the nominal value. Face value is the undiscounted amount of principal to be repaid.

[13] Paragraph 7.70 of ESA 2010. Paragraph 13.62 of SNA 2008. Paragraph 7.163 of GFSM 2014.

[14] Paragraph 20.242 of ESA 2010. ESA 2010 is consistent with SNA 2008 and GFSM 2014.

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